

Message Text

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ACTION EB-07

INFO OCT-01 EUR-12 EA-07 ISO-00 ERDA-05 AID-05 CEA-01

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R 281754Z OCT 75

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 5944

INFO AMEMBASSY BERN

AMEMBASSY THE HAGUE

AMEMBASSY STOCKHOLM

AMEMBASSY MADRID

AMEMBASSY COPENHAGEN

AMEMBASSY OSLO

AMEMBASSY DUBLIN

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AMEMBASSY BRUSSELS

AMEMBASSY BONN

AMEMBASSY ROME

AMEMBASSY ANKARA

USMISSION EC BRUSSELS

USMISSION OECD PARIS

AMCONSUL EDINBURGH

C O N F I D E N T I A L SECTION 01 OF 03 LONDON 16478

E.O. 11652: GDS

TAGS: ENRG UK

SUBJECT: NORTH SEA OIL DEVELOPMENT: AN OVERALL

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ASSESSMENT

REF: LONDON A-281; EDINBURGH 223

1. SUMMARY: THIS MESSAGE ASSESSES THE CURRENT STATUS OF BRITISH NORTH SEA OIL DEVELOPMENT. PROSPECTS FOR THE FUTURE ARE SUMMARIZED IN THE LAST PARAGRAPH. END SUMMARY

2. BETWEEN THE UK AND NORWEGIAN SECTORS OF THE NORTH SEA, POTENTIAL RECOVERABLE RESERVES TOTAL SOME 30-40 BILLION BARRELS OF OIL AND POSSIBLY 100 TRILLION CUBIC FEET OF NATURAL GAS. PRODUCTION POTENTIAL BY THE EARLY 1980S IS IN THE RANGE OF 4 TO 5 MILLION BARRELS A DAY OF OIL AND 12 BILLION CUBIC FEET A DAY OF GAS. WHILE EVEN PARTIAL PEALIZATION OF THIS POTENTIAL WILL HAVE GREAT IMPACT MN AND IMPORTANCE FOR THE BRITISH AND NORWEGIAN ECONOMIES, ONLY FULL DEVELOPMENT CAN AFFECT THE ENERGY STPATEGIES OF WESTERN EUROPE IN PARTICULAR AND THE IEA MEMBER STATES MORE BROADLY IN A TRULY SIGNIFICANT WAY. THOUGH THIS MESSAGE WILL FOCUS ON THE BRITISH SECTOR OF THE NORTH SEA, THERE IS A MEASURE OF PSYCHOLOGICAL AS WELL AS PHYSICAL INTERACTION BETWEEN DEVELOPMENT IN THE UK AND NORWEGIAN SECTORS WHICH SHOULD NOT BE OVERLOOKED.

3. IN THE EARLY DAYS OF THE NORTH SEA OIL PLAY, THE ATMOSPHERE, TONE AND PACE OF ACTIVITY WAS HECTIC AND HEADILY OPTIMISTIC. LARGE AND SMALL COMPANIES, MANY OF THE LATTER WITH SPECULATIVE FEVER BUT NO KNOWLEDGE OR EXPERTISE IN OIL, HOSTLED EACH OTHER IN THE RUSH TO OBTAIN NEW LICENSES. DRILLING RIGS AND PRODUCTION EQUIPMENT WERE DRAWN FROM OUTLYING AREAS OF INTERNATIONAL NIL INDUSTRY OPERATIONS IN ORDER TO COPE WITH NORTH SEA NEEDS. THE PROSPECTITE PROFIT PICTURE LOOKED ROSY TO THE COMPANIES AND THE GLOW EXTENDED TO GOVERNMENT, WHICH WAS COUNTING ON A "LAUNCH PAD" FOR GROWTH OF THE GENERAL ECONOMY, NEW JOBS TO HELP FIGHT UNEMPLOYMENT (ESPECIALLY IN SCOTLAND) AND A FINISH TO BALANCE OF PAYMENTS PROBLEMS.

4. WITHIN THE PAST TWO YEARS THERE HAS BEEN A GRADUAL
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EROSION IN THE LEVEL OF CONFIDENCE DISPLAYED BY THE OIL INDUSTRY AND DINANCIAL INSTITUTIONS AND AN END TO THE BONANZA PSYCHOLOGY (AND SOME OF THE SMALLER SPECULATIVE MINNOWS). INSTEAD OF VIEWING NORTH SEA BENEFITS AS A LAUNCH PAD, GMVERNMENT SLOWLY EVOLVED A "HOLD-ON-FOR-DEAR-LIFE-PRESERVER" MENTALITY UNDER THE PRESSURE OF INTERNAL AND EXTERNAL ECONOMIC AND POLITICAL FORCES. DEVELOPMENT TIMETABLES HAVE MET WITH ALARMING SLIPPAGES WHILE

ACTUAL COSTS AND COST ESTIMATES HAVE BEEN REVISED DRAS-
TICALLY UPWARD. THE TECHNOLOGICAL DIFFICULTIES OF SCAL-
ING UP OR DEVELOPING NEW STRUCTURES AND EQUIPMENT TO MEET
THE HOSTILE NMRTH SEA ENVIR"NMENT ALSO HAVE BEEN FAR
GREATER THAN INITIALLY EXPECTED. SCOTTISH NATIONALISM
AND LEFT-WING LABOR SENTIMENT FOR A GO-SLOW, STATE CON-
TROLLED APPROACH HAVE MADE THEIR MARK. DESPITE LIP
SERVICE TO THE CONTRARY, THERE ARE SERIOUS DOUBTS THAT
MANY IN IMPORTANT GOVERNMENT POSITIONS ARE STILL INTER-
ESTED PRIMARILY IN ATTRACTING MORE FOREIGN INVESTMENT AND

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R 281754Z OCT 75

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 5945

INFO AMEMBASSY BERN

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PROMOTING RAPID DEVELOPMENT. RATHER, WITH SELF-SUFFICIENCY BY 1980-81 IN SIGHT, CONCERN OVER CONSERVATION THROUGH DEPLETION CONTROLS, SURFACING OF IDEOLOGICAL OR PRAGMATIC SUSPICION OF OIL INDUSTRY MOTIVES AND ACTIONS, AND A GROWING INSISTENCE ON STRICTER NON-FISCAL DEVELOPMENT CONTROLS HAVE COME TO THE FORE.

5. EXPECTATIONS FOR FUTURE EXPLORATION AND DEVELOPMENT ACTIVITY HAVE BEEN TRIMMED BOTH BY THE INDUSTRY, IN STRIDENT PUBLIC DECLARATIONS, AND GOVERNMENT, IN PRIVATE COUNSEL. AS PREDICTED EARLIER, THIS YEAR'S EXPLORATION DRILLING HAS REACHED A PLATEAU, IF NOT A PEAK, INSTEAD OF SHOWING A SUBSTANTIAL 50 PERCENT INCREASE. LITTLE IF ANY PUBLICITY HAS BEEN GIVEN TO THE GRIM FACT THAT OUT OF MORE THAN TWENTY DISCOVERIES WITHIN THE PAST YEAR, ONLY ONE FIND HAS BEEN DECLARED "COMMERCIAL" BY AN OIL COMPANY.

6. FINANCING HAS CONTINUED TO BE A STUMBLING BLOCK AS BANKS REJECT PROJECT FINANCING AND INSIST ON SOLID BALANCE-SHEET BACKUP FOR DEVELOPMENT LOANS. ONLY THE LARGER COMPANIES WITH STRONG CREDIT RATINGS CAN RELY ON LESS THAN DETAILED SCRUTINY OF A PROPOSED BORROWING. BANKERS HAVE BEEN CONCERNED BY THE SUBSTANTIAL TECHNICAL RISKS ENCOUNTERED (WHICH THEY NOW EXPECT THE OIL COMPANIES TO SHOULDER), THE SKYROCKETING COSTS (WHICH NOW AT LEAST APPEAR TO HAVE STABILIZED) AND THE POLITICAL UNCERTAINTIES ABOUT HMG OFFSHORE POLICIES AS CONTAINED IN THE PROPOSED PETROLEUM AND SUBMARINE PIPELINES BILL SETTING UP A BRITISH NATIONAL OIL COMPANY AND IMPOSING NON-FISCAL CONTROLS ON DEVELOPMENT AND PRODUCTION, AND STILL VAGUE PROPOSALS FOR MAJORITY STATE PARTICIPATION. INCREASINGLY, THE BANKERS ALSO ARE LOOKING FOR STRONG UNDERTAKINGS, PREFERABLY IN THE FORM OF DIRECT GUARANTEES BY GOVERNMENT. ONE POSSIBLE BRIGHT SPOT, FOR BANKERS AT LEAST, IS THAT 900 MILLION POUNDS STERLING IS LIKELY TO BE MADE AVAILABLE TO THE BRITISH NATIONAL OIL CORPORATION

TO ENABLE IT TO ASSUME, UNDER WHATEVER PARTICIPATION FORMULA IS EVENTUALLY APPROVED, UP TO 51 PERCENT OF FUTURE DEVELOPMENT COSTS OF INDIVIDUAL FIELDS, THEREBY EASING THE FINANCIAL BURDEN PLACED ON EXISTING EQUITY AND DEBT HOLDERS. ANOTHER MEASURE INDIRECTLY PROTECTIVE OF BANKER
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INTERESTS WAS THE PROVISION OF THE OIL TAXATION ACT ALLOWING FOR DISCRETIONARY EXEMPTION FROM PETROLEUM REVENUE TAXES SUFFICIENT TO ASSURE A MINIMUM RATE OF RETURN AND CASH FLOW FROM NORTH SEA INVESTMENT IN MARGINAL FIELDS. BANKERS AS WELL AS SOME OIL COMPANIES STAND TO BENEFIT FROM SUCH ATTEMPTS TO PROVIDE A BASIC SUPPORT LEVEL FOR NORTH SEA PROJECTS. NONETHELESS, THE BULK OF FINANCING UP UNTIL NOW HAS BEEN PROVIDED BY A HANDFUL OF BANKS, MOSTLY AMERICAN, WHICH WOULD PREFER TO BRING IN GREATER DIVERSITY OF FUNDING SOURCES FOR ANY FUTURE FIELD FINANCING. THEY ALSO CLAIM THAT GOVERNMENT PARTICIPATION AND POSSIBLE LIMITATION ON PROFIT WILL WORK AGAINST DEVELOPMENT OF FIELDS WHICH COULD BE CLASSIFIED AS HIGH RISK/HIGH REWARD. IN BRIEF, ADDITIONAL SUBSTANTIAL NORTH SEA FINANCING IS LIKELY TO OCCUR ONLY AFTER HMG'S INTENTIONS ON PARTICIPATION ARE MADE CRYSTAL CLEAR.

7. ON-SHORE FACILITIES WHICH WERE HURRIEDLY BUILT TO PROVIDE EQUIPMENT AND SERVICES FOR OFFSHORE EXPLORATION AND DEVELOPMENT PROGRAMS HAVE BEGUN TO BE HIT BY THE SLOWDOWN IN DRILLING. A NUMBER OF PLATFORM CONSTRUCTION SITES HAVE FOUND EMPTY ORDER BOOKS AS NEW INVESTMENT HAS DRIED UP, MUCH TO THE DISMAY AND EMBARRASSMENT OF HMG WHICH, ACTING PARTLY ON INDUSTRY ESTIMATES AND PARTLY ON THE BASIS OF ITS OWN STUDIES, TOOK POWERS TO NATIONALIZE POTENTIAL CONSTRUCTION SITES OVER OBJECTIONS OF LOCAL SCOTTISH AND ENVIRONMENTALIST GROUPS. GREATER UTILIZATION OF EXISTING AND PLANNED ON-SHORE FACILITIES, WHICH ONLY A YEAR AGO WAS HELD TO CONTRIBUTE TO INFLATION AND LABOR SHORTAGES, NOW COULD BRING POSITIVE BENEFITS TO A HARD-PRESSED GOVERNMENT AT A TIME OF DEEPENING RECESSION AND UNEMPLOYMENT. THIS IS ONE PROSPECTIVE SOURCE OF SCOTTISH SUPPORT FOR PUSHING AHEAD AS PLANNED WITH RAPID NORTH SEA DEVELOPMENT.

8. THERE ARE OTHER PROSPECTIVELY BRIGHT SPOTS IN THIS LESS THAN CHEERFUL PICTURE. THE PENDULUM SEEMINGLY HAS BEGUN TO SWING BACK FROM THE RETROGRADE OF THE PAST 18 MONTHS TOWARD A MIDDLE GROUND. A NUMBER OF ECONOMIC FACTS OF LIFE AS WELL AS POLITICAL LESSONS APPEAR IN THE PROCESS OF BEING ABSORBED SLOWLY INTO THE COLLECTIVE CONSCIOUS-
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NESS OF GOVERNMENT, INDUSTRY, LENDING INSTITUTIONS,
PARLIAMENT, PRESS, SCOTLAND AND PUBLIC OPINION. AS THE

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R 281754Z OCT 75

FM AMEMBASSY LONDON
TO SECSTATE WASHDC 5946
INFO AMEMBASSY BERN
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SELLER'S MARKET FOR SUPPLIES, EQUIPMENT AND SERVICES, BOTH BRITISH AND WORLD-WIDE, HAS MODERATED, SO HAS THE DRASTIC INFLATION IN COSTS. OVER TIME, THIS SHOULD BRING RENEWED STABILITY TO INDUSTRY AND FINANCIAL PLANNING FOR EXPLORATION AND ESPECIALLY DEVELOPMENT PROGRAMMING. MORE-OVER, GOVERNMENT IS GIVING CLEARER SIGNS IN TAX, NON-FISCAL CONTROL, PROCUREMENT AND PARTICIPATION NEGOTIATIONS THAT IT IS WILLING AND ABLE TO SLOWLY, CAREFULLY, AND QUIETLY OUTMANEUVER OR FIGHT OFF EXTREMIST POLITICAL OR ECONOMIC PRESSURES. WITH ITS BACK ALMOST LITERALLY AGAINST AN ECONOMIC WALL, HMG HAS TAKEN PAINS TO CONSULT AND THEN COMPROMISE WITH INDUSTRY BASED ON REALITY RATHER THAN IDEOLOGY. PERHAPS THE ULTIMATE TEST CASE WILL BE WHETHER OR NOT IT CAN SUCCESSFULLY FIND A SATISFACTORY COMPROMISE ON THE LABOR PARTY MANIFESTO'S COMMITMENT TO MAJORITY STATE PARTICIPATION. SHOULD THIS BE POSSIBLE, THE PROPOSED FIFTH ROUND OF LICENSES SCHEDULED FOR SOME TIME IN 1976 COULD TURN OUT TO BE COMPARATIVELY SUCCESSFUL, DESPITE THE DISAPPOINTING GEOLOGICAL INDICATIONS FOR THE AREAS WEST OF THE SHETLANDS, THE CELTIC SEA AND THE WESTERN APPROACHES.

9. WHAT ARE THE PROSPECTS FOR THE FUTURE? FIRST, IT IS LIKELY THAT DESPITE DELAYS, HIGHER COSTS, TECHNICAL PROBLEMS, ETC., BRITAIN WILL REACH VIRTUAL SELF-SUFFICIENCY IN OIL AND GAS BY THE EARLY 1980S (APPROXIMATELY 2.2 TO 2.4 MILLION BARRELS A DAY). BARRING ADOPTION OF NEAR-CONFISCATORY HMG POLICIES, FIELD DEVELOPMENT ALREADY BEGUN OR PLANNED WILL CONTINUE. EVEN SHARPLY LOWER OPEC CRUDE PRICES WOULD NOT STOP NORTH SEA DEVELOPMENT ALREADY BEGUN SINCE HMG WOULD FIND IT IN ITS INTEREST TO "FORGIVE" PETROLEUM REVENUE TAX, ROYALTY OR EVEN CORPORATION TAX PAYMENTS IN ORDER TO OBTAIN BALANCE OF PAYMENTS BENEFITS FROM PRODUCING NORTH SEA CRUDE RATHER THAN IMPORT OPEC CRUDE. SECOND, UNLESS FURTHER EXPLORATION AND ESPECIALLY NEW DEVELOPMENT ACTIVITY RESUMES, BRITAIN'S PERIOD OF SELF-SUFFICIENCY COULD BE SHORT-LIVED, POSSIBLY A PERIOD OF FIVE TO EIGHT YEARS AFTER WHICH THE PRODUCTION PLATEAU WOULD SLOWLY TAIL OFF. IT IS A GOOD BET, HOWEVER, THAT HMG HAS HEARD, WILL UNDERSTAND AND ACT IN ITS OWN GOOD

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INSTITUTIONS: NO SATISFACTORY RESOLUTION OF OUTSTANDING
ISSUES, NO MOPE INVESTMENT IN NEW NORTH SEA PROJECTS.
THIRD, IT IS UNLIKELY THAT THE NORTH SEA WILL EVER AGAIN
GENERATE THE ONANZA ENTHUSIASM OF EARLIER YEARS. EX-
CESSIVE OPTIMISM BY INDUSTRY WHICH UNDERESTIMATED THE
ECONOMIC, TECHNICAL AND POLITICAL RISKS IS NOT APT TO
RETURN. ON THE OTHER HAND, NO BRITISH GOVERNMENT,
WHETHER LABOR OR CONSERVATIVE, COULD OR WOULD WANT TO
RECREATE THE CLIMATE OR ATMOSPHERE OF BOOM PSYCHOLOGY
ONCE NORTH SEA WILL HAVE BECOME A PROVEN, MATURE OIL
PROVINCE. FINALLY, THE BEST GUESS IS THAT BRITISH NORTH
SEA POTENTIAL WILL BE REALIZED TO AN EXTENT AND IN A
TIME SCALE WHICH FALLS SOMEWHERE IN BETWEEN THE "LITTLE
BRITAIN" STRATEGY OF SOME AND THE BROADER WEST EUROPEAN
OR IEA STRATEGY FAVORED BY OTHERS.

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